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Dividing the single indivisible transaction: Balancing the interests of mortgagees and innocent occupants

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I. INTRODUCTION

When a mortgagee provides the funds necessary to purchase a property, the law protects the priority of the mortgagee's security interest from any other interests in the property created after that property was purchased (unless consented to by the mortgagee). The House of Lords affirmed this principle in *Abbey National Building Society v Cann* (‘***Cann***’),[2] and rejected the technical argument based on a *scintilla temporis*[3] in favour of the policy argument concerning the need to ensure that housing loans are available and affordable. The effect of this principle is to allow the mortgagee to enforce the security interest in the property in the event of the mortgagor's default, even if there are individuals with an equitable interest in the property and who are in actual occupation.

The loan, the purchase of the property and the creation of the mortgage on the property are collectively considered by the law to be a single indivisible transaction, preventing any equitable interest from arising at any point between these stages. This is the first sense in which the transaction is said to be indivisible. The transaction is also indivisible in another sense, for the burden of the mortgagor's default on the loan is subject to no apportionment in the event that he fails to meet his payment obligations. The mortgagee is allowed to enforce the security interest and the equitable interests of the occupants of the property are irrelevant at this stage. Yet, there are situations where one may question whether this leads to a fair outcome. Where the default on the mortgage occurs due to the fraud of the mortgagor, and the mortgagee ought to have known or suspected this, it is arguable that the ‘relatively innocent’ holder of the equitable interest should not have to suffer the full burden of the consequences of the default. This was the situation facing the House of Lords in *Re North East Property Buyers Litigation* (‘***Scott***’).[4]

The term ‘one indivisible transaction’ was used multiple times in *Scott*. It is reasonable to think that their Lordships were concerned with the application of priority rules when they use the term. This article focuses on the two senses of ‘indivisibility’ of the single indivisible transaction and the *obiter dicta* of Baroness Hale in *Scott*, where she advanced arguments for adopting a less rigid approach to these two issues. For indivisibility in the first sense, Baroness Hale argued that the indivisibility of the transaction ‘depends on the facts’.[5] As for indivisibility in the second sense, her Ladyship introduced the idea of ‘innocence as a comparative concept’ and insisted on a ‘middle group’.[6] This suggests her desire for the law to develop and allow division of the burden on the basis of relative fault.

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[1] Trinity College. I am very grateful to Elizabeth Drummond for all her insightful comments and guidance. I would also like to thank the editors of the Oxford University Undergraduate Law Journal for reviewing this article.
[2] [1991] 1 A.C. 56 (HL).
[3] Literally: ‘a spark of time’. The legal meaning of the term will be described in detail later in the article.
[4] [2014] UKSC 52, [2014] 3 W.L.R. 1163. The case is also commonly referred to as *Scott v Southern Pacific Mortgages Ltd*, being the only case of ten which was still outstanding when it reached the Supreme Court.
[5] *Scott* (n 4) [115].
[6] ibid [122].

Ultimately, it will be shown that while her Ladyship's arguments may seem appealing, they represent a considerable deviation from the law at the present time. The apportionment of the burden of the mortgage default is essentially the key issue of concern as the 'single indivisible transaction' itself remains a valuable policy tool. This article will propose two statutory[7] measures to allow the courts the discretion to spread the consequences of the fraud between the mortgagee and the holder of any equitable interest in the property. It is hoped that this will enable the courts to achieve fairer outcomes in such situations. However, it is acknowledged that until there is statutory intervention, there is little that the courts can do to help the innocent occupants within the existing framework of the law. *Scott* is unlikely to be the last word on this issue and it remains to be seen how 'indivisibility' in these two senses will be challenged and developed by both statutory and judicial means.

A. THE BACKGROUND: CANN

The key facts of *Cann* are straightforward enough.[8] George Cann obtained a loan from the Abbey National Building Society ('**AN**') to buy a leasehold house. This loan was secured by a mortgage on the property. Daisy (George's mother) and Abraham Cann then moved into the house. Eventually, George defaulted on the payments of the loan and AN sought possession of the house. By way of defence, Daisy claimed that due to her financial contribution to a property previously bought jointly by George and herself, and given George's assurance that she would always have a roof over her head, she had an equitable interest in the property. She then claimed that, by virtue of her actual occupation of the property, her equitable interest took priority over AN's security interest.[9] The House of Lords decided that the loan, the purchase of the property and the creation of the mortgage on the property were all a single indivisible transaction,[10] rejecting the claim that Daisy's equitable interest arose before the house was encumbered by the mortgage.

It is reasonable to think that their Lordships considered the potential consequences of their decision on the availability and affordability of home loans. While accepting that the *scintilla temporis* might logically exist, they chose to give effect to 'reality' and held that the acquisition of the legal estate and the legal charge (mortgage) were 'simultaneous and indissolubly bound together'.[11] The interests of the individual holding the equitable interest in the property were subordinated to the public interest in the certainty of home mortgage transactions and in the availability of such mortgages.

II. DEVELOPMENT OF THE SINGLE INDIVISIBLE TRANSACTION PRINCIPLE

The single indivisible transaction principle was developed as a response to the argument for the existence of a *scintilla temporis*. The starting point to understanding the principle would undoubtedly be the *Cann* case itself where arguments for both sides were advanced. Here, the House of Lords approved the single indivisible transaction principle as being consistent with 'reality' and declared the *scintilla temporis* to be no more than 'a legal artifice'.[12] With the authority of the House of Lords, the issue was largely settled. Attempts to work around it were largely limited to trying to distinguish *Cann* rather than overrule it. In this sense, *Scott* is no exception, with their Lordships unanimously approving the principle.[13]

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[7] It is noted that Baroness Hale herself seemed to envisage a purely statutory solution, and noted that she was glad that the Law Commission would review the Land Registration Act 2002. See *Scott* (n 4) [122].
[8] *Cann* (n 2) 59-61.
[9] Daisy invoked s 70(1)(g) of the Land Registration Act 1925, which is *in pari materia* with Schedule 3 Paragraph 2 LRA 2002. This will be discussed in detail later in the article.
[10] *Cann* (n 2) 92.
[11] ibid.
[12] ibid 93.
[13] *Scott* (n 4) [114].

A. THE OVERRIDING INTEREST OF ACTUAL OCCUPATION

Consider three parties: A, the mortgagor of a property; B, the mortgagee of a property; and C, the owner of a beneficial interest in the property. C may have gained the beneficial interest from A in a variety of ways, whether by contribution to the purchase price of the property, through proprietary estoppel, by contract, or various other means. In order to purchase the property, A takes a loan from B and grants B a legal charge over the property as part of the mortgage agreement. A then defaults on the payments of the loan and B seeks possession of the property.

The only way that C can defeat B's claim to possession is by showing that he has an interest which has priority to B's legal charge. However, s 29(1) of the Land Registration Act 2002 ('**LRA 2002**') has the effect of postponing the priority of all unprotected interests in the land at the point of the mortgage to immediately after the legal charge. Essentially, if an interest is not protected, the legal charge will have priority to it.

C's interest will be protected if it is a registered charge or the subject of a notice in the register.[14] Alternatively, C's interest will also be protected if C is in actual occupation of the property and thus can prove that he has an overriding interest. The latter mechanism relies on s 29(2)(a)(ii) and Schedule 3, Paragraph 2 of the LRA 2002. If C can show that he has a proprietary interest,[15] is in actual occupation of the property and does not fall foul of the additional exceptions in Schedule 3 Subparagraphs 2(b) and (c),[16] his interest will not be postponed in priority to after the execution of the legal charge. This interest can potentially bind B and defeat his claim to possession of the property.

The crucial question then becomes: when did C's beneficial interest arise? If it arose after the legal charge was granted, then there is no question of changing its priority, and the legal charge has priority to it. If, however, it arose before the legal charge was granted, then the actual occupation mechanism as previously described may help maintain its priority as against the legal charge.

B. UNDERSTANDING THE SCINTILLA TEMPORIS

The House of Lords in *Cann* held that before the property was transferred to A, C could not possibly have had any proprietary interest in the property.[17] A himself did not have any proprietary interest in the property and, consistent with the *nemo dat* principle,[18] any interests he might have given to C were at best personal rights enforceable only against himself (and therefore incapable of binding third parties).[19] It is only when A received the property that the equitable rights held by C could be 'fed' by the acquisition of the legal estate and become proprietary rights.[20] Depending on when the estoppel was 'fed', C might have a proprietary interest which had priority to the legal charge.

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[14] s 29(2)(a)(i).
[15] *National Provincial Bank Ltd v Ainsworth* [1965] AC 1175 (HL) held that a purely personal right against A will not suffice.
[16] The actual occupation mechanism will be defeated if the following can be shown under subpara 2(b) that an inquiry was made of C and he failed to disclose the right when he could reasonably have done so. Alternatively, under subpara 2(c), the mechanism is defeated if C's occupation would not have been obvious on a reasonably careful inspection of the land at the time of the disposition and if B did not have actual knowledge of his interest.
[17] *Cann* (n 2) 92.
[18] *Nemo dat quod non habet* (literally: 'no one gives what he does not have').
[19] *Scott* (n 4) [50]. Lord Collins here explains the decision in *Cann.*
[20] *Cann* (n 2) 89–90. The mechanism is explained in detail in *Scott* (n 4) [71].

In *Cann*, counsel for C advanced the argument that 'the transaction necessarily involved conveyancing steps which […] must be regarded as taking place in a defined order, so that there was a '*scintilla temporis*' between the purchaser's acquisition of the legal estate and the creation of the society's charge during which the estoppel could be fed'.[21] In other words, there must have been a moment in time, however brief, where A held the fee simple of the property, unencumbered by the legal charge, after which the grant of the legal charge took effect. This moment in time was described as the *scintilla temporis* (the grant of the legal charge must necessarily have been executed after A received the fee simple of the property, for he could not grant it without first having a proprietary interest in the property).[22]

If the *scintilla temporis* did indeed exist, then the estoppel would have been fed in that brief moment and C would have acquired a proprietary interest prior to the granting of the legal charge. The actual occupation mechanism as described earlier would then prevent s 29(1) LRA 2002 from postponing the priority of C's interest to after that of the legal charge. C would be able to assert his proprietary rights against B, resisting B's claim for possession.

C. REJECTION OF THE SCINTILLA TEMPORIS: THE SINGLE INDIVISIBLE TRANSACTION

Their Lordships in *Cann* acknowledged the 'attractive legal logic' of this argument but ultimately rejected it as 'flying in the face of reality'.[23] Lord Oliver gave two main reasons for deciding that the acquisition of the legal estate and the legal charge were 'simultaneous and indissolubly bound together'. The first reason was that the acquisition of the legal estate was entirely dependent upon the funds from B. It would arguably not be fair to subordinate B's security interest to C's equitable interests where C would never have obtained the equitable interest without B's loan in the first place. The second reason given was that in most cases, conveyancing practice was that the documents for the legal charge would have been executed before the transfer of the legal estate to A (in terms of the sequence of execution of documents, not their legal effect). To say that the law logically required a different ordering of the stages would be to ignore what actually happens in practice and to insist on a technicality.

Lord Oliver then neatly summed up the effect of the single indivisible transaction, explaining that A 'never in fact acquires anything but an equity of redemption'.[24] If A receives the legal estate when it was already burdened with the legal charge of B, then he cannot possibly go on to give any right to C which has priority over that of B's legal charge. Accordingly, C has no interest which priority might be protected by the actual occupation mechanism. The legal charge has priority over C's equitable interests and B's claim for possession will succeed.

III. DEVELOPMENTS IN THE LAW AFTER CANN

A. THE BACKGROUND: SCOTT

In order to understand *Scott* fully, it is necessary to appreciate the context in which the cases arose. 'Sale and rent back' schemes ('**SRB**') are arrangements designed and marketed by private companies.

[21] *Cann* (n 2) 90.
[22] ibid 101.
[23] ibid 92.
[24] ibid 93.

The company arranges purchases a property from the homeowner using a loan from a bank secured by the property itself. As the company promises to give the homeowner an extended lease (sometimes a life interest) in the property, the homeowner is attracted by the prospect of obtaining quick money while still being able to reside in the property. In return, the company charges the homeowner a hefty 'fee', deducted from the purchase price of the property.[25]

Even if the commercial viability of such schemes were not seriously questionable, the arrangement has some serious problems. First of all, in order to get the loan from the bank, the company is normally asked to declare that there are no outstanding leases on the property beyond 12 months.[26] This is standard bank policy and the companies would have to make a false declaration in order to get the loan in the first place. Secondly, there is a nasty tendency of the companies to suddenly abscond once they received their 'fee'.

Scott is a typical SRB case, with the original homeowner, Rosemary Scott ('**RS**'), effectively agreeing to sell her house to Amee Wilkinson ('**AW**') at a price substantially below the market rate, having been promised the right to indefinite occupation at a discounted rent. Amee took out a loan from Southern Pacific Mortgages Ltd ('**SP**'), using the house as collateral and then promptly defaulted on the payments and disappeared.

Our previous model involving A, B and C remains valid, though with some additional information. C is a homeowner who sells the property to A. The beneficial interest that C obtains from A in this case results from representations made by A that he will grant a lease to C so that he can stay in his own property even after the sale (raising a proprietary estoppel). As before, A then defaults on the mortgage payments and, in this case, disappears.

B. THE SUPREME COURT IN SCOTT CONSIDERS CANN

The facts in *Scott* were different from those in *Cann* and the Supreme Court considered two main questions:[27]

1) Whether A could grant proprietary, as opposed to merely personal, rights to C before he acquired the legal estate; and

2) Even if C had proprietary rights, whether *Cann* applied to prevent him from asserting an equitable right that had arisen only on completion.

The key difference between the two cases lies in the contract signed in *Scott*. Counsel for RS in *Scott* argued that her interest arose pre-completion and that this enabled them to distinguish *Cann*. They effectively argued that since her interest existed during the period between contract and conveyance, it slipped in before the legal charge took effect.

The argument is based on the existence of a vendor-purchaser constructive trust. The roots of a vendor-purchaser constructive trust can be found in the case of *Lysaght v Edwards*,[28] where Jessel MR held that once there is a 'valid contract for sale, the vendor becomes in equity a trustee for the purchaser of the estate sold, and the beneficial ownership passes to the purchaser'.[29]

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[25] It is noted that since 1 July 2009, the Financial Conduct Authority has regulated firms that offer SRB. The interim scheme ran from 1 July 2009 and was replaced by the current scheme on 30 June 2010.
Financial Conduct Authority, 'Sale and rent back' <http://www.fca.org.uk/firms/financial-services-products/mortgages/sale-and-rent-back> accessed 1 July 2015.
[26] *Scott* (n 4) [5].
[27] ibid [10].
[28] (1876) 2 Ch D 499 (Ch).
[29] ibid 506.

Applying this to the facts of *Scott*, AW would have had a beneficial (and proprietary) interest in the property before completion, with (rather counterintuitively on the facts) RS as the trustee of that interest. AW's promise to RS would then be capable of giving RS a proprietary interest, since AW would have had a sufficient interest in the property from which to make that gift at the time.

The argument based on a vendor-purchaser constructive trust was rejected by both Lord Collins and Baroness Hale, though their reasoning differed. Lord Collins held that the 'contract, conveyance and mortgage are indivisible'[30] and that 'it would be wholly unrealistic to treat the contract for present purposes as a divisible element in this process'.[31] Thus, the interest granted by A to C can only be personal in nature until such point where A is conveyed the legal estate. Then the estoppel is 'fed' and C's beneficial interest gains proprietary character.[32] Lord Collins then held that *Cann* would apply to *Scott*, with the effect that the acquisition of the legal estate and the grant of the charge would be one indivisible transaction.[33] Baroness Hale rejected the constructive trust argument on the basis that 'the purchaser of land cannot create a proprietary interest in the land, which is capable of being an overriding interest, until his contract has been completed'.[34]

C. DOES SCOTT GO FURTHER THAN CANN? STILL AN INDIVISIBLE TRANSACTION

From this point onwards, everything their Lordships considered is strictly speaking *obiter dicta*, since the legal issues in *Scott* were resolved when Lord Collins held that A could not grant proprietary rights to C before he acquired the legal estate. The case was decided solely by answering the first question, rendering the answer to the second question (with all the discussion of indivisibility) inconsequential.[35] However, it will soon be apparent that the *obiter dicta* in this case provides much more fertile ground for analysis and development of the law than the *rationes*, which does little more than affirm *Cann*.

Lord Collins went on to consider whether the single indivisible transaction analysis extends to situations where the equitable interest is said to arise at the time of the contract of sale.[36] He affirmed the judgment of Aldous LJ in *Nationwide Anglia Building Society v Ahmed*[37] that it was implicit in *Cann* that contract, conveyance and mortgage are indivisible.[38] Lord Collins conceded that the contract of sale has separate legal effects, but argued that it would be wholly unrealistic to treat the contract for present purposes as a divisible element in the process.[39] Lord Collins thus seemed to think that there is in substance a single indivisible transaction which effectively prevents any beneficial interest of C from ever having priority over B's legal charge in such 'mortgage situations', regardless of the time between each individual component of the transaction.

[30] *Scott* (n 4) [85].
[31] ibid [87].
[32] *Scott* (n 4) [71]–[72].
[33] ibid (n 4) [79].
[34] ibid [122].
[35] It is noted that Lord Wilson and Lord Reed expressly acknowledged that the indivisibility of the contract from the conveyance and the mortgage was not part of the reasons for the decision. See *Scott* (n 4) [123].
[36] *Scott* (n 4) [70]. In doing so, he accepts that his statements are made *obiter.*
[37] (1995) 70 P & CR 381 (CA).
[38] *Scott* (n 4) [85].
[39] ibid [87].

IV. THE FIRST SENSE OF 'INDIVISIBILITY': DIVIDING THE TRANSACTION ON THE BASIS OF THE FACTS

Baroness Hale's *dicta* in *Scott* are by far the most interesting and have the most potential for development. As far as the *rationes* of the case went, she agreed with Lord Collins' judgment. However, with respect to Lord Collins' *dicta* on the single indivisible transaction, she preferred to adopt a different and more flexible approach.[40] It is noted that she had the support of the majority of the Supreme Court on this point, with Lord Wilson and Lord Reed supporting her[41] and Lord Collins and Lord Sumption taking a different position.

There are two points being considered here. Baroness Hale seemed firm on the first point, namely, that the contract, conveyance and mortgage do not constitute a single indivisible transaction. She insisted that there is no 'tripartite transaction to which vendor, purchaser and lender are all party'.[42] In addition, she considered that to insist that these factors constitute a single indivisible transaction would be to 'fly in face of the facts' and 'create confusion'.[43] On the other hand, she seemed willing to accept that the conveyance and mortgage may constitute a single indivisible transaction, albeit that this depends on the facts.[44] On the first point, Baroness Hale presented a persuasive argument[45] and this article will not address it further.

A. DEPENDING ON THE FACTS

On the second point, the single indivisible transaction rule in *Cann* was thought to apply to all cases where A took out a mortgage with B to purchase the property. However, Baroness Hale held that this need not be the case in every situation. She held that 'not all conveyances are indivisible: it depends on the facts'.[46] While we were not told what characteristics will persuade the court to depart from the general finding of an indivisible transaction, Baroness Hale provided us with at least one situation. She confirmed that 'if the mortgage takes place sometime after the conveyance, there may be a period during which the purchaser owns the land without encumbrances'.[47] The difficulty with this statement is that it provides little guidance as to how long 'sometime' might be.

Baroness Hale's assessment of the *Cann* line of cases may shed some light on what is required to show that there was no indivisible transaction. She held that in the cases of *Coventry*[48], *Woolwich*[49], *Piskor*[50] and *Cann* the conveyance and the mortgage were virtually contemporaneous and the mortgage loan was required to complete the transaction.[51] Her Ladyship also accepted that in *Ahmed*[52] there was an indivisible transaction because the transactions all took place on the same day and each of the participants knew what the terms of the arrangements were.[53]

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[40] *Scott* (n 4) [95].
[41] ibid [123].
[42] ibid [119].
[43] ibid [120].
[44] ibid [115].
[45] ibid [116], [119]–[120]. The most persuasive argument is that the contract to sell the land is an entirely separate matter from the mortgage and the conveyance. There is no reason for the default position to be that they all occurred simultaneously. Technically speaking, for the single indivisible transaction rule to exist, B and C need not even know that the other exists, let alone that A and B have made a contract together.
[46] *Scott* (n 4) [115].
[47] ibid.
[48] *Coventry Permanent Economic Building Society v Jones and Others* [1951] 1 All ER 901 (Ch).
[49] *Woolwich Equitable Building Society v Marshall* [1952] Ch 1 (HL).
[50] *Church of England Building Society v Piskor* [1954] Ch 553 (CA).
[51] *Scott* (n 4) [109].
[52] ibid.
[53] ibid [121].

There is also Baroness Hale's assessment that *Universal Permanent Building Society v Cooke*[54] may not have been wrongly decided, indicating that her Ladyship agreed with the principles laid down in *Cooke*. Therefore, in order to understand the factors that determine whether an indivisible transaction exists, it is useful to analyse *Cooke*.

The facts of *Cooke* are briefly stated as follows. Cooke leased out her flat to Gavine on a weekly tenancy before obtaining the fee simple of the property. Cooke was conveyed the fee simple of the property on 28 December 1948 and mortgaged the property the following day. She subsequently defaulted on her payments of the loan and the bank sought possession. Gavine argued that she had a tenancy by estoppel and sought to resist the order for possession. The Court of Appeal held that there was nothing to suggest that the conveyance and the mortgage were part of a single transaction.[55] It found itself bound on the facts of the case to deem the two transactions as being two independent transactions, the mortgage taking place a day after the conveyance.[56]

Regarding the case of *Cooke*, Baroness Hale seemed to think that it can be argued that the transaction was not indivisible because the transaction was not contemporaneous (mortgage executed one day after the conveyance) and because there was no evidence that the mortgage was required for the purchase.[57] Baroness Hale did not commit herself to a position, though she noted that it was likely that the House of Lords in *Cann* knew about *Cooke* and did not expressly overrule it or even mention it.[58]

This suggests three factors which militate towards a finding of an indivisible transaction: 1) The transactions took place contemporaneously (on the same day), 2) the mortgage loan was required to complete the transaction; and 3) each of the parties knew what the terms of the arrangements were.

The first possible distinguishing factor of *Cooke* is intellectually unsatisfying. To argue that a transaction is divided and not a single whole simply because the constituent procedures were completed a single day apart is a highly doubtful proposition. If the law is willing to accept that the *scintilla temporis* argument is a mere technicality, then it should similarly be willing to look past a single day's delay and assess the substance of the transaction. Lord Collins also seemed unconvinced that counting the number of days between the constituent procedures is a good way to go about assessing the transactions as well. He noted that while in *Ahmed*, the contract and conveyance were executed on the same day, the (indivisible transaction) analysis is not dependant on that.[59]

The second possible distinguishing factor of *Cooke* may be more promising. If the mortgage is not required for the purchase of the property, then the conveyance and the mortgage will not be part of a single indivisible transaction. This factor seems to make perfect sense. The very reason for insisting on a single indivisible transaction in *Cann* itself was because the acquisition of the legal estate is entirely dependent on the provision of funds from the lender.[60] However, what this really suggests is not that *Cooke* is an exception to the single indivisible transaction rule in *Cann*, but that *Cooke* was never caught by the rule in the first place. *Cann* only applies where the mortgage is required to acquire the property. This point has been uncontroversially accepted since *Cann* itself.

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[54] [1952] Ch 95 (CA).
[55] *Cooke* (n 54) 101.
[56] ibid.
[57] *Scott* (n 4) [110].
[58] ibid.
[59] *Scott* (n 4) [85].
[60] *Cann* (n 2) 92.

The third possible distinguishing factor is reasonable. If the innocent occupant in particular knew about the terms of the arrangements, one might reasonably expect him to raise the issue of his equitable interests to the mortgagee. Remaining silent about the false pretences on the basis of which the loan was obtained (if not for the false pretences, the loan would not be given in such circumstances) leaves open the accusation that one is an accomplice to a fraud. However, though knowledge of the terms of the arrangement is a strong factor for finding that there was a single indivisible transaction, it is not clear that the reverse applies. The existing framework and rationale for the single indivisible transaction is largely based on conveyancing practice and policy arguments, not fault arguments. It is only when there is sufficient fault to vitiate the contract that it becomes relevant. Even if the innocent occupant did not know the full terms of the arrangements, this does not affect the realities of conveyancing practice or policy justifications in any way. If fault arguments are to be introduced, it is argued that they are better considered at the stage of apportioning the burden of the transaction rather than when dealing with the quite technical point regarding whether the transaction is indivisible or not. These arguments will be considered later.

After analysing all the cases, Baroness Hale's statement that things will be 'dependent on the facts' really provides us with no more information than the statement itself. We have no guidance as to when this exception might apply or whether there might even be any cases where the exception could apply at all. At its narrowest interpretation, we might construe the statement as stating that the single indivisible transaction rule does not apply to cases where the mortgage is not required to purchase the property; a largely redundant statement.

Of course the statement can be interpreted in a far wider manner than that. With no guidance as to what 'dependent on the facts' mean, the courts now have the potential to make decisions in a more flexible manner. However, bearing in mind that Baroness Hale's statements are non-binding *dicta* and that they do not provide much guidance, it is highly unlikely that any subordinate court would be too keen to prioritise it over *Cann*, which is technically very much still good law. It seems that this attempt at 'division' of the single indivisible transaction is unlikely to have any significant impact on the law.

V. THE SECOND SENSE OF 'INDIVISIBILITY: DIVIDING THE BURDEN OF THE TRANSACTION

At the end of her judgment, Baroness Hale expressed some uneasiness about the decision. She noted that the law insisted on an 'all or nothing' approach.[61] Either C could prove that there was some reason in equity to restrain B from enforcing the security as against C's right altogether, or B would be able to totally disregard C's rights and enforce its security. As far as equitable remedies in such situations go, the law has been unwilling to depart from this 'all or nothing' approach and apportion the burden of loss between the two (relatively) innocent parties once the third party has either absconded or been made insolvent. In *TSB Bank Plc v Camfield*[62] the court insisted that it had no power to award partial rescission.[63] To the court, rescission was an all or nothing process and the right of the representee and not of the court. The court could not grant equitable relief to which terms may be attached.[64]

[61] *Scott* (n 4) [122].
[62] [1995] 1 WLR 430 (CA).
[63] ibid 436.
[64] ibid 438-439.

A. UNDERSTANDING THE HARSHNESS OF THE LAW

In 2013, there were more than 220,000 claims for possession made in England and Wales[65] as mortgagors defaulted on their loans. Since *Cann* was decided, there have been other cases where the security has been successfully enforced by the banks with no compensation to the occupants of the properties with beneficial interests. While the loss of a family home is one which undoubtedly evokes a sense of sympathy, the courts have long since steeled themselves against prioritising the few individuals before them, aware of the consequences on the rest of society if they did so. It is thus interesting that the Supreme Court, the barristers involved in the case, and the majority of authors writing on this issue have felt that the victims in *Scott* and the 'sale and rent back' cases deserve special sympathy.

The special element which seems to evoke such sympathy is likely to be the fact that the homeowners affected by such schemes were victims of fraud. The victims were promised money and the right to stay for extended periods in their properties (sometimes for life). They never for a moment thought that they would be evicted from their own homes. There is a fundamental (and emotive) difference between on the one hand moving into a new property with the expectation of a proprietary right and then being denied performance of that expectation, and being evicted from one's own home after receiving express assurances that this would not happen on the other. Lord Collins himself noted that even if the victims receive monetary compensation, it does not change the fact that they have lost their homes.[66]

B. IS THE LAW REALLY THAT HARSH?

The full picture is a little more complicated than that. Thomas Tyson argues that the whole structure of a 'sale and rent back' transaction is a 'preposterous' and 'eminently resistible' one.[67] The vendor releases some equity in the property, but receives little in return.[68] Tyson compares the deal to one to exchanging a cow for some magic beans,[69] implying that the promised leases and/or bonus payments are simply too good to be true. One cannot help but feel that *caveat emptor* may be an apt expression in these cases.

As to monetary compensation, it is unlikely that the mortgagors who organised the whole scheme will be found or indeed be solvent on any level. But that does not mean that the victims are totally bereft of any remedy. Lord Collins noted that the victims may have claims against the Solicitors' Compensation Fund[70] and it is always possible that professional negligence claims may be brought. It is possible that there will be some negligence or wrongdoing on the part of the solicitors, whether it lies in being accomplices to the mortgagors or failing to give proper advice to the victims. All things considered, there is probably still a need for the law to intervene to help these victims as these remedies are inadequate. However, they should be considered as part of the overall compensation framework.

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[65] Ministry of Justice 'Mortgage and Landlord Possession Statistics Quarterly: October to December 2013' (Ministry of Justice Statistics Bulletin, 13 February 2014) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279342/mortgage-landlord-possession-statistics-oct-dec-2013.pdf> accessed 1 July 2015.

[66] *Scott* (n 4) [24].

[67] Thomas Tyson 'Magic beans for that cow? *Scott v Southern Pacific Mortgages* [2014] UKSC 52' (Zenith Chambers News and Articles, 24 October 2014) <http://www.zenithchambers.co.uk/cms/document/scott_v_southern_pacific_article.pdf> accessed 1 July 2015.

[68] ibid

[69] ibid

[70] *Scott* (n 4) [24].

C. INNOCENCE AS A COMPARATIVE CONCEPT

When arguing for a middle ground approach between the 'all or nothing' approach of the current law, Baroness Hale advanced an approach that would use relative fault to apportion the burden of the loss between B and C.[71] She argued that there might be a point where a vendor who has been *tricked* out of her property can assert her rights even against a subsequent purchaser or mortgagee.[72] From the point of view of the lenders, she argued that there might be a point where the claims of lenders who have failed to heed the obvious warning signs that would have told them the borrower was not a good risk should be postponed to those of vendors who have been made promises that the borrowers cannot keep.[73] Baroness Hale then expresses her approval of the plans of the Law Commission to review the impact of fraud in the LRA 2002.[74] These statements make it apparent that her Ladyship was concerned mainly with fraud as the ground for granting equitable relief.

Baroness Hale argued that lenders may relatively be at fault when they fail to heed the 'obvious warning signs' that the borrower was not a good risk.[75] This statement has the potential to produce very controversial outcomes. It seems to suggest that even if B has no knowledge of the situation, vulnerabilities or even existence of C, B's actions may constitute sufficient 'fault' to make it bear some of the losses. It is argued here that even if we are to use a concept of 'comparative innocence', any 'fault' on the part of the parties must be sufficiently linked to the other party they are splitting the losses with. So, it is less controversial to suggest that if B knew or should have known that C would potentially suffer loss from his actions, we might want to impose duties to C on B.[76] Undue influence works in a similar manner and we can understand how the concept of constructive notice works.[77] It is far more controversial, however, to suggest that B, potentially having no knowledge of the existence of C, should effectively owe a duty to C to heed the 'obvious warning signs' given by A. In equity (fiduciary duties) and in tort (negligence) it is rare for one to owe a duty to a party whose existence one is unaware of, even as part of a class of persons. Simply put, if B does not know that C exists, B can act solely in his own interests without having to worry about the interests of any third parties.

It would be a lot less controversial to suggest that Baroness Hale's 'comparative innocence' concept should be restricted to cases where B knows or at least suspects the existence of C. On the other hand, while C inevitably knows of the existence of B in such cases, that need not be a requirement. One need not know of a duty's existence to be owed a duty.

In practice, lenders are rather keen to ensure that they get good security for their loans. It is most unlikely that they will grant loans to borrowers who are 'obviously not good risks'. Furthermore, standard mortgage terms generally permit only shorthold tenancies of fixed term no more than 12 months.[78] If there were clear signs that A was making a false declaration on the form or intending to break this term, it is unlikely that any bank would have granted him the loan. The prospect of not having the right to vacant possession is not a welcome one, and few lenders would knowingly walk into a transaction like that. The whole reason why the transaction occurred in the first place was due to the lack of full disclosure by A to B. Hence, the kind of transactions that are likely to arise in practice are cases of constructive notice, where the mortgagee should have known about the risks in granting the mortgage but still went ahead. This may occur due to poor design of the system, human error or just plain negligence (in the ordinary sense of the word).

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[71] *Scott* (n 4) [122].
[72] Emphasis added.
[73] *Scott* (n 4) [122].
[74] Law Commission, *Twelfth Programme of Law Reform* (Law Com No 354, 2014) paras 2.13- 2.16.
[75] *Scott* (n 4) [122].
[76] Indeed this seems to be the rationale behind the exceptions in Schedule 3 paragraph 2, LRA 2002.
[77] See *Barclays Bank Plc v O'Brien* [1994] 1 A.C. 180 (HL) and *Royal Bank of Scotland v Etridge (No 2) and other appeals* [2001] UKHL 44, [2002] 2 AC 773. *Etridge* is the leading case.
[78] *Scott* (n 4) [5].

D. EXISTING COMMON LAW REMEDIES

The closest existing common law principles potentially available to protect the victims are those of unconscionability, undue influence and misrepresentation. However, none of them really seems applicable to the situation, and even so, on the authority of *TSB v Camfield*, all of them entail 'all or nothing' remedies. As there is no direct contractual relationship between B and C, and quite possibly no dealings at all between them at all, a successful plea of any of these vitiating factors would merely render the contract between A and C voidable. As the legal charge has already been granted to B, this would not assist C.

While the doctrine of constructive notice in undue influence may seem more promising in such cases, the fact remains that B and C have no contractual relationship and constructive notice has not yet been expanded to include cases where there is no contractual relationship between the victim and the party with supposed constructive notice. The contracts are between A and B, and between A and C. Even if B knows or ought to have known about C's situation, there is no scope for the application of undue influence principles. What Baroness Hale was considering is a form of action which can work even when the only link between B and C is their link with A. The common law currently does not provide a remedy to C against B in such a situation. A statutory solution will indeed be required. A 'proposed statute' will be considered later in this article. Before it is covered in detail, the necessary characteristics of this hypothetical 'proposed statute' will be discussed.

E. APPORTIONMENT OF LOSSES: A LESSON FROM HISTORY

If such a situation seems familiar, it is because this is not the first time that the courts have had to deal with the issue of apportionment of the burden of loss between two (relatively) innocent parties. Roughly half a century ago, Devlin LJ expressed his dissatisfaction with the 'all or nothing' approach in *Ingram v Little*,[79] a case concerning mistake of identity involving a fraudster who then dropped out of the picture. As is currently being done with this issue, the issue then was taken up by the Law Commission, which published their response in their Twelfth Report (Transfer of Title to Chattels (Cmnd 2958, 1966)).[80] The idea of apportioning losses flowing from cases of mistake was rejected by the Law Commission. Diamond argues that the rejection was largely based on two grounds. The first ground was that a power of apportionment would result in uncertainty following from the grant of a wide and virtually unrestrained judicial discretion. The second ground was the insistence of the Law Commission that in cases where both parties were innocent, the loss should lie where it falls.[81]

A good half a century has passed since that report. Also, the subject matter here, being land, is likely to raise very different considerations.[82] However, it is important for us to consider the reasons for the rejection of a very similar power to apportion losses in the law of mistake. The second ground of rejection of the proposal is unlikely to be an issue here. Baroness Hale implied that such a power should only be exercised where there is not only relative fault, but apparently a rather high level of relative fault on the part of the lenders.[83] As regards the first ground of rejection, certainty in the law is of paramount importance in ensuring that the home loans and mortgages system flows smoothly. The question we have to ask is: 'will the proposed statute create an acceptable level of uncertainty this time?'

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[79] [1961] 1 QB 31 (CA).
[80] Aubrey Diamond summarised and commented on the report under the Reports of Committees section of the Modern Law Review; see further (1966) 29 MLR 418.
[81] ibid 414.
[82] The difference in treatment of legal issues relating to land as compared with the other areas of private law is well established and (largely) well justified. For an in depth consideration of this point, see Peter Birks, 'Before We Begin: Five Keys to Land Law' in Bright and J Dewar (eds*) Land Law: Themes and Perspectives* (OUP 1998).
[83] *Scott* (n 4) [122].

It is tempting to argue that since 'sale and rent back' transactions are now regulated by the Financial Conduct Authority[84] and the market has in practice shut down,[85] we should compensate the victims of such transactions as it would be unlikely to affect the supply of home loans.[86] However, there are a significant number of fraud cases in property transactions each year. Any attempts to restrict the effect of the proposed statute to only 'sale and rent back cases' will be open to the fair criticism of being unprincipled. It is highly difficult to justify theoretically why victims of such schemes in particular will have a new remedy available to them while it is denied to the victims of other kinds of fraud in property transactions. The danger is that, in trying to do justice to a small group of people we end up distinguishing the law in unprincipled ways, or worse, changing the law such that it affects confidence in standard commercial transactions and does more harm than good.

On the other hand, if we were to expand the scope of the proposed statute to include fraud in property transactions in general, it would be difficult to control the level of uncertainty generated. Unlike transactions tainted by undue influence, it is impossible for lenders to effectively screen such transactions. In undue influence cases, there is at least some form of dealings between the lender and the victim making it potentially reasonable for us to attribute constructive notice to the lenders and thereby protect the victim's interest should the lenders not discharge their duties in ensuring that the victim is properly legally advised. Fraud cases have a wide variety of forms and B and C need not even have met or had any dealings with each other at all in some of these situations.

F. STATIC AND DYNAMIC SECURITY

We are faced once again with the one of the core problems of land law, that of balancing static and dynamic security. Very briefly, static security involves a preference for protecting the title of the original owner against subsequent purchasers, whereas dynamic security involves protecting the subsequent purchasers instead. The decision to prioritise dynamic security was already made with the passing of the LRA 2002,[87] with Parliament weighing the options and accepting that there might be a few cases where property owners would be disadvantaged by the rules. The intention behind s 29 and, more broadly, the LRA 2002 itself, was that the old doctrines of notice (and particularly, constructive notice) should no longer apply.[88] Excepting the concession of overriding interests, buyers should simply be able to rely on the Register when making their decisions as to the property. The 'relative fault' that is considered when apportioning losses under the proposal is most likely to come from judgments as to what B knew or should have known about C and his situation.[89] This completely goes against the intention behind the 2002 Act as it effectively requires B to investigate C's situation. This more or less resurrects the old doctrine of notice, something which was expressly removed by the 2002 Act.

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[84] Since 2009, initially by the Financial Services Authority under s 19, Financial Services and Markets Act 2000. This is now governed by the Financial Conduct Authority.
[85] *Scott* (n 4) [2].
[86] Given that such transactions effectively no longer exist, even if the banks tightened their loans criteria for such transactions, it would not make much difference to the market.
[87] This is inherent in numerous provisions in the LRA 2002, including s 26, s 29, s 58. For a more in-depth consideration, see Amy Goymour [2013] CLJ 617.
[88] Law Commission, *Land Registration for the 21st Century: A Consultative Document* (Law Com No 254, 1998) paras 3.44 – 3.50.
[89] It was noted earlier that it would be controversial to allocate liability to B where B does not know of C's existence.

It is noted that Baroness Hale and the Law Commission may have had different things in mind when her Ladyship made her comments about the Law Commission's plans. With the developments in how the courts now deal with the impact of fraud on the Land Register (see the *Malory*[90] and *Fitzwilliam*[91] line of cases), it is likely that the focus of the Law Commission will be on fraud which results in void dispositions and its impact on the register and the application of Schedule 4 and Schedule 8 of the LRA 2002. Baroness Hale's statement may now prompt the Law Commission to look into this particular area, but it is likely that when the statement was made, the Law Commission intended to review the law on fraud pertaining to land registration rather than on the allocation of losses in cases of fraud. It is expected that the Report, when published, will still predominantly focus on the former issue.

In summary, it is argued that the fully understandable sympathy which Baroness Hale and the rest of the Supreme Court felt for the victims of 'sale and buy back' schemes should not be translated into any changes in the law. Parliament has already made its decision (twice, if we count the proposals on reforming the law of mistake) that an 'all or nothing' approach is justified on pragmatic grounds. The *dicta* of Baroness Hale do not seem to have added any substantial fresh ideas to this debate. One suspects that the Law Commission will make a critical and thorough assessment of the issue and come to the same conclusion which its predecessors did half a century ago.

G. MITIGATING THE HARSHNESS AND THE POWER TO MAKE DISCRETIONARY ORDERS

As noted earlier, the primary loss to the victims is likely to be their eviction from their property. Barring those cases where the solicitor lacked professional indemnity insurance or was truly free from any wrongdoing, the victims may receive compensation from either the Solicitors' Compensation Fund or as a result of professional negligence claims. This provides Parliament with an opportunity to assist these victims.

A potentially acceptable solution might be to confer upon the courts the power to exercise discretion to:

1) Freeze any attempts to take possession of or sell the mortgaged property until the conclusion of any proceedings by the victims to seek compensation from A and/or B (proceedings to be brought in a reasonable amount of time);[92] and

2) Order a sale of the property to the victims at fair market value within a reasonable time from the conclusion of the abovementioned proceedings.

B should be able to claim a fair interest rate for the loan (which C should have to pay regardless of whether C eventually buys the property back or not), which C in turn should be able to claim in the compensation proceedings. The idea is for the victims to be in a position to use their compensation to purchase their property back. It is noted that since C did receive some money in the initial transaction (which has probably already been spent), C may need to take out a loan in order to make up for that shortfall and buy back the property. Unfortunately, if the victims were themselves substantially at fault and/or it is not possible to extract any compensation from the solicitors involved, the victims may have to bear the full losses themselves.

[90] *Malory Enterprises Ltd v Cheshire Homes (UK) Ltd* [2002] EWCA Civ 151, [2002] Ch. 216
[91] *Fitzwilliam v Richall Holdings Services Ltd* [2013] EWHC 86 (Ch), [2013] 1 P. & C.R. 19
[92] The solution would fundamentally be an equitable remedy and equitable laches would probably apply.

H. ALTERNATIVE MEASURES

While the idea of dividing the burden of the transaction between B and C has been largely rejected in this article, it is possible to envisage some models for doing so. There are two kinds of potential losses suffered. One is the loss of possession of the property (which cannot be apportioned), while the other is the pecuniary loss suffered due to the transaction. The two models based on tort and equity allow for C to be compensated by B, regardless of whether the solicitor is additionally liable for damages. C will not be allowed to recover an amount greater than his loss from B and the solicitor. Where relevant, B and the solicitor can then bring proceedings to apportion the losses between themselves.

Two measures will be proposed, one relying on a duty in equity and the other relying on a duty in tort. The two measures require different statutory provisions to be enacted. The proposed duty in equity would resemble the current approach used in undue influence cases. A statutory duty could be imposed on B; not to ensure that C was given independent legal advice as in undue influence cases, but to conduct reasonable investigations as to the situation of C and ascertain the nature of the contract between A and C. The duty would not apply where B was unaware of the existence of C, but B would be required to conduct reasonable investigations as to that point where he suspected that C (as a class of persons) might be involved.

If the duty was breached, the first step would be to determine the relative fault of the parties. Then, the losses due to each party should be calculated in proportion to such relative fault. A new statutory mechanism would be required for determining the relative fault and it is suggested that the existing Law Reform (Contributory Negligence) Act 1945 ('**LRCNA**') could be modified to fulfil this role. As it is impractical to expect the banks to retain the property indefinitely, the default position would be that C should get the fee simple of the property, but only if C pays B a sum corresponding to B's share of the losses. If C fails to pay this sum, then B would be allowed to enforce the security, but must then pay C a sum corresponding to C's share of the losses. This model requires three new statutory mechanisms: 1) the power to order the conveyance of the property to C; 2) the power and mechanism to determine relative fault; and 3) the power to apportion losses.

Alternatively, the tort model involves the creation of a statutory duty of care on the part of B. B would be under a duty to C to take reasonable steps to ascertain whether C exists if he has reason to suspect it, and then to conduct reasonable investigations as to the situation of C, including ascertaining the nature of the contract between A and C. The standards expected by the duty in equity and tort should be similar in practice.

If the duty was breached, the LRCNA 1945, s 1(1)[93] could be applied directly to the case. The interpretation of 'fault' in s 4[94] is wide enough to include relative fault as considered in this situation. It is unlikely that the facts of such cases will be sufficient to persuade the courts to grant an order of specific performance that B not act in contravention of C's beneficial interests in the property. Thus, a statutory provision is likely to be necessary to provide for discretion to exercise this power. As noted earlier, it is impractical to expect the bank to hold onto the property indefinitely. The default position would be that the courts would order that B convey the fee simple of the property to C; provided that C pays B a sum corresponding to B's share of the losses. If C fails to pay this sum, then B would be allowed to enforce the security, but must then pay C a sum corresponding to C's share of the losses. This model requires two new statutory mechanisms: 1) the creation of a statutory duty of care owed by B to C; and 2) the power to order the conveyance of the property to C.

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[93] s 1(1): Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage.

[94] 'Fault' means negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence.

The two models have some shortcomings. The equity model runs into the problem that *TSB v Camfield* still does not allow apportionment of loss, requiring express statutory intervention to get around this problem. The tort model has the advantage of utilising the well-established rules in the LRCNA but requires the creation of a statutory duty of care. In practice, their effects should be similar. Also, if the models are narrowly drafted such that they apply only to 'sale and rent back' transactions, they can be criticised on the grounds that they are unprincipled. If they are broadly drafted to include fraud in property cases in general, then they are likely to create too much uncertainty in the home loans and mortgages market. In addition, there are complications arising from the fact that both B and C expected A to hold onto the property and perform his obligations to the two of them. With A out of the picture, B cannot be expected to hold onto the property until C's proprietary interest runs out. C similarly cannot be forced to buy the property. These models can deal with the allocation of pecuniary losses, but at best aid C in getting his property back. There are no guarantees at that point. Nevertheless, they represent models which could feasibly work if Parliament is willing to bear the costs mentioned above.

VI. CONCLUSION

At a superficial level, *Scott* seems to promise a departure from the orthodoxy of the single indivisible transaction. Where in the past conveyances and mortgages were part of an indivisible whole (for this category of cases), *Scott* suggests that they may now be divisible 'depending on the facts'.[95] Where there was rigid insistence on an 'all or nothing approach', *Scott* now suggests a middle approach where burden of the losses of the transaction may be apportioned based on the grounds that 'innocence is a comparative concept'.[96]

However, once we look at the substance of those statements, we realise that they provide little by way of guidance for their application. As mere *obiter dicta*, it is unlikely that subordinate courts will attempt to rely on these statements in distinguishing the cases before them from the orthodoxy approved by no less than the House of Lords.[97] The lack of clear guidance as to the meanings of these statements coupled with very plausible narrow interpretations only makes their task more difficult. This means that *Scott* as it currently stands is unlikely to have any impact on the law. The single indivisible transaction seems to remain indivisible as ever.

It may be just as well that this is so. From both theoretical and pragmatic standpoints, the Supreme Court seems to have arrived at a reasonable decision in their judgments. One can feel a great sympathy for the victims involved while recognising that sympathy need not translate into legal rights or even evoke feelings of injustice. Apportioning losses between (largely) innocent parties is not an easy task and what the Law Commission and Parliament think as to its feasibility has already been established.

Objectively speaking, if the victims can obtain compensation for their losses,[98] then the loss of their property (while serious) may not constitute a grave injustice. If Parliament is willing to intervene, it is submitted that their focus should be on giving the victims an opportunity to buy their houses back (suffering some losses), rather than on attempting to apportion the losses between the parties. The former approach may actually stand a chance of being enacted into law. It is certain that we have not heard the last word on this issue, however one gets the general impression that the significant commercial implications on the home loans market mean that there will be much discussion on this issue, but very little actual change.

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[95] *Scott* (n 4) [115].
[96] ibid. [122].
[97] *Cann* (n 2).
[98] *Scott* (n 4) [24].